



SOUTHESK
ENERGY LTD

1995 Annual Report

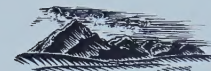
A large, light blue, stylized letter 'P' is positioned on the left side of the page, serving as a background element for the title.

RESIDENT'S MESSAGE

TO THE SHAREHOLDERS

Southesk Energy Ltd. has completed its first full year of operations as an oil and gas fund, and we are very pleased with our overall achievements in spite of a less than buoyant stock market during the past twelve months. Southesk Energy Ltd. shares and share purchase warrants were first listed for trading on the Alberta Stock Exchange (symbol: SEE, and SEE.wt) in August, 1994. One common share and one share purchase warrant were initially issued as a unit for \$2.00; SEE shares subsequently traded between \$2.75 and \$1.75 and lately have levelled off in the \$2.30 - \$2.40 range. Similarly, the warrants, exercisable at \$2.25 per share until March 1, 1996 trade in the 35c - 40c range.

The oil and gas stock market has not been particularly strong since Southesk Energy Ltd. became a publicly traded



company. In fact, the TSE Oil/Gas Index had not recovered by June 30 to the July-August, 1994 levels. Nevertheless, any losses incurred in a portion of our portfolio have been offset completely by gains in other purchases. One of the most significant was our holding of Vista International Petroleum Ltd., purchased at an average cost of \$1.29 per share, and tendered last month to a \$2.20 per share buyout by a private company. We look for the same success with some of our other holdings.

The merger/acquisition activity level has been increasing steadily over the past few months. We believe this trend will continue well into 1996. Companies as varied in size as Mannville Oil & Gas Ltd., The RIMOIL Corporation, Quadron Resources Ltd., and Home Oil Limited have been bought out by other oil industry participants.

Southesk Energy Ltd. was extremely pleased to acquire Frank D. McEachern as the company's Security Advisor. Your Board of Directors felt that Mr. McEachern was the top oil and gas analyst in Calgary and to have him advise the company on a day to day basis is a real bonus. Frank analyzes oil and gas stocks from annual reports and news releases then attends annual and special meetings and most important of all meets personally with the top management of the oil companies before he determines whether or not Southesk should invest in those company's shares. This, as individual shareholders, we are unable to do but we receive this benefit by being shareholders of Southesk Energy Ltd.

All purchases and sales transactions have been taken on the advice of Frank McEachern who forwards via fax a

written recommendation related to a particular Buy or Sell idea, the approximate number of shares, and a suggested price range within which to conduct the transaction. Generally our portfolio consists of between seven and eight oil stocks at any one time, although it has had as many as ten.

Oil and natural gas prices, while not weak, are notably lower than in the past few years - particularly so in the case of natural gas. Expectations for price strengthening for either commodity in the near term are not common, indeed, in the case of crude oil, futures prices are lower next year than at present. Whether it actually turns out that way will not be known for another 8 - 12 months. There is a surplus of natural gas and inadequate transportation facilities to move much of that product to markets, particularly in the northeastern U.S.A.

Companies recommended by the Security Advisor may face those problems as well, but are also seen to have fundamental share value not yet recognized in the market place, thus providing good capital appreciation potential.

We encourage all Southesk shareholders to exercise their share purchase warrants prior to March 1, 1996, after which they have no value. The additional funds will be invested in other promising oil and gas shares.

Respectfully submitted,

R.G. Ingram, C.A.
President

FRANK D. McEACHERN

is an independent oil

& gas analyst based in

Calgary, Alberta. He is

the author of the monthly

McEachern Oil Letter

and serves as the advisor

to Southesk Energy Ltd.



THE YEAR IN REVIEW

AN INTRODUCTION

Stock market performance for oil and gas companies was anything but buoyant during our first year of operation. The TSE Oil and Gas Index stood at 4710.07 on August 1, 1994 and closed at 4443.73 at our year end.

There are a number of reasons for this and they include, but are not limited to the following:

1. Natural gas prices have been in a free fall all year declining from over \$2.00 per MCF to the current \$1.00 per MCF level.
2. Oil prices have traded in a narrow range during the year but the futures market prices are below current prices. This does little for investors confidence in this sector.
3. There have been a number of "train wrecks" in the industry i.e. companies that made acquisitions using bank

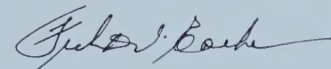
debt because they thought that the price of gas and oil was going to increase significantly. Now the banks want to be repaid and these companies have been forced to sell producing properties to pay down debt or face bankruptcy.

4. A lot of companies raised money by selling shares to investors in 1993. Investors were told that the money would be used to increase the cash flow of the company. Companies that failed to deliver on these promises have seen their shares severely punished by disgruntled shareholders fleeing these stocks. This "sheep like" behaviour of large institutional investors, who long ago perfected the art of selling first, and thinking later, has led to the stocks of oil and gas companies being out of favour with investors. Cycles come and cycles go but the time to buy shares is when they are out of favour.

Subsequent to year end we experienced an occurrence that I'm sure has happened to a lot of investors. You can never have enough shares in stocks that go up and you always have too many in the ones that go down. We have tendered our shareholding in Vista International (Winner) to a take over bid and sold our position in Harbour Petroleum (Loser).

Despite all the doom and gloom, we have been adding to our current stock positions in companies that we believe are trading at bargain prices. The companies that we held at year end are reviewed on the pages that follow.

I look forward to addressing the shareholders at the annual meeting to be held in Edmonton, at the Petroleum Club on Friday, October 20, 1995 at 4 p.m.



Frank D. McEachern



CIMARRON PETROLEUM LTD. (CIR - TSE)

Corporate revenues are fairly evenly split between oil, and gas sales - all from properties in Alberta: from the Peace River Arch in the northwest, through the central part of the province, including Bashaw. Beginning in late 1991, the company commenced a horizontal well drilling project in the Del Bonita field in southern Alberta. That field is considered one of the larger oil pools in the province in terms of oil-in-place. It was discovered many years ago, but was never a highly productive pool. Vertically drilled wells in Del Bonita produced at only minimal rates, so it was presumed that one or more horizontally drilled wells would prove to be very productive. Success seemed so near, and yet so far. No commercial oil production was ever attained from the project, so CIR

extricated itself from the whole affair and returned to the more conventional exploration and development of oil and gas.

Development at Valhalla in northwestern Alberta has been much slower than expected because the project is operated by another company, thus making the rate of development more difficult to control. Drilling prospects during the first half of 1995 emphasized gas prospects, but since early July, a shift to oil projects has been made, primarily because of the currently weak natural gas markets. There appears little likelihood of price improvement for another year or so. Recent production volumes are: 2100 bpd of crude oil and NGL's (natural gas liquids), and 33 mmcf of natural gas per day.

FOSSIL OIL & GAS LIMITED (FOL - TSE)

Shares of this company trade in the market at a sharp discount to Net Asset Value: \$2.40 vs a real value of $\pm$ \$3.75. Corporate revenue comes from oil (70%), natural gas (24%), and other (6%). "Other" may include interest income, management fees, etc. The Company has no debt - in fact over 25¢ per share is in cash.

Fossil is a victim of the aftermath of the exuberant 1993 oil and gas market boom: retail and institutional investors alike bought anything and everything. Now some of those same institutional investors are dumping many of their smaller capitalized holdings, regardless of price. One particular institution recently acquired a new portfolio manager - an individual who had no prior knowledge of the capital appreciation

potential of Fossil, nor cared to learn. His only interest was in divesting his portfolio of Fossil shares into the market. We believe that the recent price weakness in shares of Fossil provides an excellent opportunity to "average down" in price. Such purchases are considered prudent when the fundamentals of a company continue strong - certainly true in this case. Because we believe this value will eventually be recognized in the market place, the fund is continuing to purchase common shares of Fossil.

FOL operates in Alberta, mainly in the southern and eastern sectors of the province. Crude oil and natural gas liquid production is relatively constant at 550-600 bpd, whereas sales of natural gas are rising from recent levels of 3.3 mmcf of natural gas per day.



HARBOUR PETROLEUM COMPANY LIMITED (HRP-TSE)

Shares of Harbour were purchased during the fourth quarter of 1994 at a time when the growth prospects appeared to be excellent. However, just into the new year, the Company announced a property purchase of producing natural gas, and undeveloped acreage, for the sum of almost \$17-million, equivalent to 90¢ per mcf for the

producing reserves, a price almost identical with wellhead prices - obviously a most expensive and inappropriate purchase, as reflected in the market place subsequent to that transaction. The potential for price appreciation appears to be zero for an indefinite period of time: the common shares of HRP have been sold.

PETROSTAR PETROLEUMS INC. (PPE - TSE)

Shares of this company were purchased with the view that capital appreciation would occur this year, due to a projected significant jump in revenue from new natural gas production from the Hamburg and Talbot Lake prospects, both in northern Alberta. For 1994, the revenue split was approximately 49% from oil, and 51% from natural gas. This year has seen a slight shift to 53% and 47% respectively because the Talbot Lake property is not yet on production. For 1996, the revenue distribution is estimated to be 35% (oil), and 65% (natural gas).

Start-up of the Talbot Lake gas property was delayed one year because of intervention by the Lubicon Indian Tribe, who while not owning any of the lands subject to or affected by the proposed Nova pipeline connection, nevertheless felt that their traditional hunting lands were being violated. The differences were settled amicably but the winter-only pipeline construction period was lost. The Company now expects to commence gas deliveries next April, and if so, revenue and cash flow should show a major increase over a financially poor 1995.

SAXON PETROLEUM INC. (SXN - ASE)

Saxon common shares have not been a notable stock market performer for some time, due in part to the following: (i) the previous financings concluded with Enron Gas Marketing Canada, Inc. have been poorly understood, if at all. The assistance from Enron enabled Saxon management to obtain a larger credit line than available from a bank, thus permitting the company to make larger property purchases than it otherwise could manage. Repayment was via prepaid contracts for specified quantities of crude oil and/or natural gas at predetermined prices. Year-end 1994 debt/cash flow ratio was 4.3 years - meaning that it would take 4.3 years of 1994 cash flow to repay the full loan. By year-end 1996, that ratio is estimated to be in the range of 1.5 years at 1996 cash flow rates. The relationship with Enron has now come to a close and the necessary financial assistance has been reassigned to a conventional bank; (ii) SXN shares trade only on the Alberta

Stock Exchange, thus limiting the availability to various institutional accounts, which are not permitted to purchase shares on that exchange. A listing on the Toronto Stock Exchange is expected some time this fall; (iii) the large (41-million) number of shares issued and outstanding - a formidable number for such a small company. It is considered by some to be a disadvantage. Whether it is or not is purely conjecture.

Corporate revenues for 1995 expected to come from oil (61%) and the remaining 39% from natural gas. Recent production volumes: 1200 bpd and 10 mmcf/day. Heavy rainfall this summer in parts of Western Canada adversely affected the tie-ins of recently drilled oil and gas reserves. In some cases, this has been the wettest summer in many years. Many surface leases are isolated and inaccessible, and a return to normal oilfield activity will of necessity be deferred until this winter.

STRIKE ENERGY INC. (SEN - TSE)

Effective July 1, 1994, Battle Creek Developments Ltd. and Strike Energy Inc. merged to form the new Strike Energy Inc. Because BCV shareholders owned approximately 65% of the new corporate entity, the accounting treatment reflected that BCV was the acquiring company, and therefore its historical results would carry forward. BCV's revenue sources were approximately 28% from crude oil, and 72% from natural gas, and pipeline operations. Since the merger, a shift in revenue sources has occurred: 51% from oil, 37% from natural gas, and the remaining 12% from gas gathering and processing fees. Cash flow now comes almost equally from Alberta and Saskatchewan.

Significant oil development and production areas are the Twining field in Alberta, Tatagwa, Viewhill, Kingsford, and the heavy-oil 100% interest property at Bolney, all in Saskatchewan. That latter prospect has an estimated 100-million barrels of oil in place. This field may be the "company maker." The pool is now providing SEN with approximately 1100 bopd, a volume that may become 1500 bopd by year-end. The product no longer has a stigma in regard to price - in fact, heavy oil is much in demand now and thus commands a very favourable price at the wellhead. The field is being developed by drilling horizontal wells, each well contributing about 150-200 bopd. Somewhere between 10 and 12 wells should be producing at that level by the end of this year.



VISTA INTERNATIONAL PETROLEUMS LTD. (VSI.A -TSE)

Shares of this company did not trade well; it was not well known, being headquartered in Regina, but it was one of the most undervalued holdings in our portfolio. The Net Asset Value was twice the usual market price. The Company operated entirely in southeastern Saskatchewan, and derived almost all revenue from the production and sale of crude oil. Minor revenue came from management fees and natural gas sales. Vista was an example of a "winner" (but far too few shares!). Subsequent to

SEE's year end, a private company - Palindrome Energy Ltd. on August 12, 1995 made a cash offer of \$2.20 per share for all Vista shares. While that price is below a NAV of \$2.50-\$2.75 per share, depending upon the particular Discount Rate of Cash Flow, nevertheless it is considered a fair offer for both the buyer and seller. All company directors, collectively holding approximately 35% of the common shares agreed to the offer. Our holdings of Vista purchased at an average cost of \$1.29 per share were tendered to the offer.

ZARGON OIL & GAS LTD. (ZAR -TSE)

Common shares of Zargon were first listed for trading on the Alberta Stock Exchange in October 1993, during a time of sharp market downturns. By March 1994, the shares were accepted for trading on the Toronto Stock Exchange. The Company was incorporated in 1987 for the purpose of acquiring producing oil and gas assets in western Canada. Zargon is not well known at present but the Company has long had strong investment support from individuals both in Canada and the USA, and just weeks ago successfully concluded a \$1-million+ financing with private investors based in Toronto. The Company is managed in a very conservative manner - no wild exploration participation. Management is cognizant of enhancing shareholder value.

Over 85% of corporate revenue currently comes from the production and sale of crude oil; the remaining 15% from

natural gas. Producing properties extend from Boundary Lake (BC) through northwestern Alberta in gas prone areas, the Joarcam oil field southeast of Edmonton, and into southeastern Saskatchewan. The Company recently announced plans to evaluate approximately 14,000 acres (75% Zargon interest) in southeast Saskatchewan described as the "Pipestone" project which apparently has multi-zone oil potential. Management seeks to develop long-life reserves, which tends to promote stability and dependable revenue and cash flow even in periods of low product prices. Recent production levels were: 930 bopd and 3 mmcf/day.

Shares of Zargon are considered to be undervalued: it is very easy to make a case for a NAV of \$1.85 (or more) per share at a Discount Rate of 10% per year. For that reason, additional fund purchases of Zargon shares have been made since fiscal year-end.

AUDITOR'S REPORT

J U N E 3 0 , 1 9 9 5

To the Shareholders of
SOUTHESK ENERGY LTD.

We have audited the balance sheet of **SOUTHESK ENERGY LTD.** as at June 30, 1995, and the statements of earnings and retained earnings and changes in financial position for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit

also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 1995, and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles.



DELOITTE & TOUCHE
Chartered Accountants

July 21, 1995

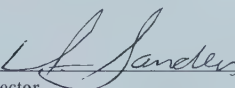
	<u>1995</u>	<u>1994</u>
REVENUE		
Gain on sale of investments	\$ 50,322	\$ -
Interest income	21,242	-
	71,564	-
EXPENSES		
Advisory fees	16,902	-
Office and administrative	4,941	-
Professional fees	2,100	-
Rent	10,700	-
	34,643	-
EARNINGS BEFORE INCOME TAXES	36,921	-
INCOME TAXES (Note 5)	3,568	-
NET EARNINGS AND RETAINED EARNINGS, END OF YEAR	\$ 33,353	\$ -
EARNINGS PER SHARE		
Basic and fully diluted	\$.035	\$ -

	<u>1995</u>	<u>1994</u>
CURRENT ASSET		
Cash and term deposits	\$ 450,935	\$55,000
INVESTMENTS (Note 3)	1,148,618	-
	\$ 1,599,553	\$55,000
CURRENT LIABILITIES		
Accounts payable	\$ 2,000	\$ -
Income taxes payable	3,568	-
	5,568	-
SHAREHOLDERS' EQUITY		
Share capital (Note 4)	1,560,632	55,000
Retained earnings	33,353	-
	1,593,985	55,000
	\$ 1,599,553	\$55,000

APPROVED BY THE BOARD



Director



Director

	1995	1994
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	\$ 33,353	\$ -
Item not affecting cash		
Gain on sale of investments	(50,322)	-
	(16,969)	-
Changes in non-cash operating working capital items		
Accounts payable	2,000	-
Income taxes payable	3,568	-
	(11,401)	-
INVESTING		
Purchase of investments	(1,514,799)	-
Proceeds on disposal of investments	416,503	-
	(1,098,296)	-
FINANCING		
Share issue costs	(144,368)	-
Issuance of share capital	1,650,000	55,000
	1,505,632	55,000
NET CASH INFLOW	395,935	55,000
CASH AND TERM DEPOSITS, BEGINNING OF YEAR	55,000	-
CASH AND TERM DEPOSITS, END OF YEAR	\$ 450,935	\$55,000

1. NATURE OF BUSINESS

The Company was incorporated under the provisions of the Business Corporations Act of Alberta, on March 8, 1993. The Company holds investments in oil and gas companies and commenced operations on July 1, 1994.

2. ACCOUNTING POLICIES

These financial statements have been prepared in accordance with generally accepted accounting principles and include the following significant accounting policy:

Investments

Investments are recorded at cost. When it becomes apparent that a permanent decline in the value of an investment has occurred, the investment is written down to reflect such a decline.

3. INVESTMENTS

	# of shares	Cost	Market
Cimarron Petroleum Ltd.	10,000	\$ 121,775	\$117,500
Vista International Petroleum Ltd.	130,050	167,194	182,070
Fossil Oil & Gas Ltd.	50,000	154,163	132,500
Harbour Petroleum Company Ltd.	40,000	159,705	44,400
Saxon Petroleum Inc.	300,000	168,500	144,000
Petrostar Petroleum Inc.	119,600	194,211	123,188
Strike Energy Inc.	52,400	125,459	159,820
Zargon Oil & Gas Ltd.	44,300	57,611	58,033
	746,350	\$1,148,618	\$961,511

4. SHARE CAPITAL

Authorized

Unlimited number of voting common shares

Issued	<u>1995</u>	<u>1994</u>
962,500 common shares (1994: 137,500 common shares)	<u>\$1,560,632</u>	<u>\$55,000</u>

During the year, the Company issued through a public offering 750,000 units consisting of one common share and one warrant for cash consideration of \$1,355,632, net of issue costs of \$144,368. Each warrant entitles the holder to purchase one common share of the Company at an exercise price of \$2.25 on or before March 1, 1996. In connection with the offering, the Company granted its Agent an option to purchase 75,000 units at a price of \$2.00 per unit. During the year, this option was exercised and an additional 75,000 shares were issued for a cash consideration of \$150,000.

Of the 962,500 issued voting common shares, 70,200 shares are held in escrow pursuant to a policy of the Alberta Securities Commission and may not be released from escrow without the consent of the Chief of Securities Administration.

5. INCOME TAXES

The Company's effective tax rate approximates 44%. The provision for income taxes does not reflect this rate as the Company is allowed to deduct a portion of share issue costs in determining its taxable income over a five year period.

6. RELATED PARTY TRANSACTIONS

A Director of the Company is also a partner in a legal firm which provided services in connection with the issuance of share capital in the amount of \$11,449 during the year.

Head Office

Southesk Energy Ltd.
#1, 12415 Stony Plain Road
Edmonton, Alberta
T5N 3N3
Ph (403) 482-2450
Fax (403) 488-3002

Officers

Robert G. Ingram, President
David S. Rowand, Secretary

Directors

Robert G. Ingram*
David S. Rowand *
David Sanders
Craig Paul*
* Audit committee

Auditors

Deloitte & Touche
2000 Manulife Place
Edmonton, Alberta
T5J 4E4

Legal Counsel

Rowand, Lopatka & Savich
#210, 17010 - 103 Avenue
Edmonton, Alberta
T5S 1K7

Bank

Canadian Western Bank
11350 Jasper Avenue
Edmonton, Alberta
T5K 0L8

Transfer Agent

Montreal Trust
411 - 8th Avenue S.W.
Calgary, Alberta
T2P 1E7

Consultant

Frank McEachern
#401, 1732 - 9 A Street S.W.
Calgary, Alberta
T2T 3E6

Listed

Alberta Stock Exchange:
SEE, and SEE.wt

SOUTHESK ENERGY LTD.
#1, 12415 Stony Plain Road
Edmonton, Alberta T5N 3N3
Ph (403) 482-2450
Fax (403) 488-3002